FILED
DEC 21 1955
HAROLD B. WILLEY, C

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 584

FRANK GENTLES, DON F. GATES, RANDOLPH CALDWELL and FRANCIS V. NIXON,

Appellants,

vs.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, F. BRITTON McCONNELL, Insurance Commissioner of the State of California, as Liquidator of The Pacific Mutual Life Insurance Company of California, and PACIFIC MUTUAL LIFE INSURANCE COMPANY, a California corporation,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

JURISDICTIONAL STATEMENT

ALFRED McCORMACK,
JOHN LOGAN O'DONNELL,
Attorneys for Appellants

PEYTON FORD,
ALAN Y. COLE,
Of Counsel

INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Questions Presented	3
Statement of Facts	5
1. Parties	5
2. Seizure of Old Company in 1936; Creation of New Company; 1936 Rehabilitation Agreement	5
3. Mutualization provisions of Rehabilitation Agreement	8
4. Mutualization proceedings	9
5. Finding as to practicability of mutualization	10
6. Fixing of the Purchase Price	11
7. Provisions for payment of purchase price	14
8. Proceedings Below	15
9. Res Judicata	21
Substantial constitutional questions are raised on this appeal	22
Substantive due process	22
Procedural due process	35
Conclusion	40

DEC 24 1957

2567733

CITATIONS

PAGE

CASES:

Alabama Comm. v. *Southern R. R.*, 341 U. S. 341.. 38
Application of Prudential Insurance Company, 132 N. J. Eq. 170 22
Atchison R. R. v. *Pub. Util Comm*, 346 U S. 346 3

Backus v. *Fort Street Union Depot Co.*, 169 U. S. 568 25
Belden v. *Union Central Life Insurance Co.*, 143 Ohio St. 329 22
Buchanan v. *Warley*, 245 U. S. 60 26

Caminetti v. *Pacific Mut. L. Ins. Co.*, 23 Cal. 2d 94 8
Caminetti v. *Pacific Mut. L. Ins. Co.*, 23 Cal. 2d 334 8
Carpenter v. *Pacific Mut. L. Ins. Co.*, 10 Cal. 2d 307 .....6, 7, 39
Carpenter v. *Pacific Mut. L. Ins. Co.* (not officially reported), Superior Court, Los Angeles County, December 3, 1936 6
Carpenter v. *Pacific Mut. L. Ins. Co.*, 13 Cal. 2d 306 8
Case v. *Los Angeles Lumber Co.*, 308 U. S. 106...21, 38
Cherokee Nation v. *Kansas R. R.*, 135 U. S. 641... 25
Connecticut Co. v. *Palmer*, 305 U. S. 493 35

Dahnke-Walker Co. v. *Bondurant*, 257 U. S. 282... 2
Doty v. *Love*, 295 U. S. 64 22

Ecker v. *Western Pacific R. R.*, 318 U. S. 448....23, 38
Eubank v. *Richmond*, 226 U. S. 137 22

Garrison v. *Pacific Mut. L. Ins. Co.*, 83 Cal. App. 2d 1 8

Hamilton v. *Regents*, 293 U. S. 245 3

In re Equitable Office Bldg. Corp., 96 L. Ed. 1386, not officially reported 23
In re Prudential Insurance Company, 82 N. J. Eq. 335 22

PAGE

Jacobs v. *United States*, 290 U. S. 13 29

Kelley v. *Everglades District*, 319 U. S. 415 38

Lake Erie & W. R. R. v. *Pub. Util. Comm.*, 249 U. S. 422 3
Live Oak Assn. v. *R. R. Commission*, 269 U. S. 354 3
Lord v. *Equitable Life Assurance Society*, 194 N. Y. 212 22
Louisville Bank v. *Radford*, 295 U. S. 555 30

Matter of Casualty Co. (Rubin Claim), 244 N. Y. 443 40
Matter of Globe & Rutgers Ins. Co., 148 Misc. 497 23
Matter of Lawyers Mortgage Co., 169 Misc. 802, *aff'd*, 256 App. Div. 974 40
Matter of Nemerov, 149 Misc. 797 40
Matter of New York Title & Mortgage Co., 171 Misc. 489 .....25, 40
Matter of New York Title & Mortgage Co., 168 Misc. 60 40
Monongahela Navigation Co. v. *United States*, 148 U. S. 312 25
Morgan v. *United States*, 298 U. S. 468 35

Nashville C. & St. L. R. R. v. *Walters*, 294 U. S. 405 2
Neblett v. *Carpenter*, 305 U. S. 297 .....6, 7
Neblett v. *Pacific Mut. L. Ins. Co.*, 22 Cal. 2d 393 8
Niagara Hudson Corp. v. *Leventritt*, 340 U. S. 336 38

Ohio Valley Co. v. *Ben Avon Borough*, 253 U. S. 287 37
Old Dearborn Co. v. *Seagram Corp.*, 299 U. S. 183 26
Olson v. *United States*, 292 U. S. 246 .....22, 25

Penn Co. v. *Pennsylvania*, 294 U. S. 189 38
Pennsylvania v. *Williams*, 294 U. S. 176 38
Phelps v. *United States*, 274 U. S. 341 29

RFC v. *Denver R. R.*, 328 U. S. 463 38
Rippel v. *Prudential Insurance Company*, 85 N. J. L. 395 22
St. Joe Paper Co. v. *Atl. Coast Line R. R.*, 347 U. S. 298 23
St. Joseph Stockyards Co. v. *United States*, 298 U. S. 38 38
Sanborn v. *Pacific Mut. L. Ins. Co.*, 42 Cal. App. 2d 99 8
Seaboard Air Line R. R. v. *United States*, 261 U. S. 299 29
SEC v. *Central-Illinois Corp.*, 338 U. S. 96 .....23, 38
Standard Oil Co. v. *Johnson*, 316 U. S. 481 2
Sweet v. *Rechel*, 159 U. S. 380 25
Thompson v. *Consolidated Gas Co.*, 300 U. S. 55... 26
Union Dry Goods Co. v. *Georgia P. S. Corp.*, 248 U. S. 372 22
United Railways v. *West*, 280 U. S. 234 38
United States v. *Westinghouse*, 339 U. S. 261..... 36
West Ohio Gas Co. v. *Comm.*, 294 U. S. 79..... 35

STATUTES:

Constitution of the United States, Amendment XIV 4, 21, 26, 37
U. S. C. Title 28, Section 1257(2).....2, 3, 22
California Code of Civil Procedure
Section 1094.5 .....2, 37
California Insurance Code
Section 986 6
Section 1037(e)..... 5
Section 1043 3
Sections 1045-56 3
Section 11525 16
Section 11526 16
Section 11527 .....16, 20
Sections 11525-27 .....3, 15, 35, 36

PAGE

Page's Ohio Code, Chapter 3913 37

MISCELLANEOUS:

Best's Life Insurance Reports, 1955 15

Davis, Administrative Law (1951), Chapter 19, "Nonreviewable Action" 39

Parish, The Mutualization of a Legal Reserve Stock Life Insurance Company, 11 Proc. of Assn. of Life Insurance Counsel 475, 479-483 (1952-1953) 37

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. .....

FRANK GENTLES, DON F. GATES, RANDOLPH CALDWELL and FRANCIS V. NIXON,

Appellants,

vs.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, F. BRITTON McCONNELL, Insurance Commissioner of the State of California, as Liquidator of The Pacific Mutual Life Insurance Company of California, and PACIFIC MUTUAL LIFE INSURANCE COMPANY, a California corporation,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

JURISDICTIONAL STATEMENT

This is an appeal from a judgment of the Supreme Court of California affirming (with three judges dissenting) a judgment of the Superior Court for Los Angeles County which denied a petition for a writ of mandate to review and set aside an order of the State Insurance Commissioner approving a plan for the mutualization of appellee Pacific Mutual Life Insurance Company (the "New Company").*

*This Jurisdictional Statement is filed on behalf of the appellants named in the caption. The other parties who have appealed from the judgment below have filed a separate Jurisdictional Statement.

Opinions Below

The opinion of the California Supreme Court and the two dissenting opinions are reported. 44 Cal. 2d 715, 285 P. 2d 636 (Appendix A). The opinion of the District Court of Appeal is reported. 270 P. 2d 584 (Appendix B). Neither the opinion of the Superior Court, filed March 24, 1952, nor that of the Insurance Commissioner, dated September 22, 1950, has been reported. They are printed as Appendices C and D.

Jurisdiction

(1) The proceeding below was brought under § 1094.5 of the California Code of Civil Procedure (App., E 12-14), which provides for review of administrative orders and decisions by writ of mandate.

(2) The date of the judgment of the California Supreme Court sought to be reviewed was June 27, 1955 (App. H). A petition by appellants for rehearing was denied without opinion, three judges dissenting, by order entered July 27, 1955. Notice of appeal to this Court was filed with the Clerk of the California Supreme Court on October 24, 1955.

(3) The jurisdiction of this Court is invoked under § 1257(2) of the Judicial Code, 28 U. S. C. § 1257(2).

(4) Cases believed to sustain the jurisdiction are *Dahnke-Walker Co.* v. *Bondurant*, 257 U. S. 282; *Standard Oil Co.* v. *Johnson*, 316 U. S. 481, and *Nashville C. & St. L. R. R.* v. *Walters*, 294 U. S. 405, holding that a proper case for appeal is presented where the validity of a state statute, as construed and applied, is drawn in question on the ground of repugnancy to the Federal Constitu-

tion; and *Lake Erie & W. R. R.* v. *Pub. Util. Comm.*, 249 U. S. 422; *Live Oak Assn.* v. *R. R. Commission*, 269 U. S. 354; *Hamilton* v. *Regents*, 293 U. S. 245; and *Atchison R. R.* v. *Pub. Util. Comm.*, 346 U. S. 346, holding that an order of a State administrative body or official, made in the exercise of delegated legislative authority, is a "statute" within the meaning of 28 U. S. C. § 1257(2).

(5) The validity of §§ 11525-27 of the Insurance Code of California (App., E 9-12), as construed and applied in this case, is involved. Related statutes of California, the constitutionality of which is not involved, but which have a bearing on the case, are California Insurance Code §§ 1043 and 1045-56. (App. E 1-9).* The validity of the Insurance Commissioner's order (App. D), as a statute within the meaning of 28 U. S. C. § 1257(2), is also involved.

Questions Presented

The Plan of Mutualization approved by the Insurance Commissioner provides for the purchase by the New Company of all its outstanding capital stock. It binds appellants, who are among the equitable owners of the stock, to a sale at a price determined as of 1948, but payment of which will not be made until the distant future, *i.e.*, between 1971 and 1983, if, as and when certain conditions precedent shall have been satisfied.

The questions presented are whether the order of the Commissioner, the judgment below and §§ 11525-27 of the California Insurance Code, as construed and applied in this case, deprive appellants of property without due process

*There is no official edition of the statutes of California.

of law contrary to Amendment XIV of the Constitution, (1) *substantively,* because the Plan of Mutualization:

(a) deprives appellants of the incidents of their equitable ownership of the stock, for a period that may extend to 1983, without compensation and without a definite and unconditional obligation to purchase and pay for the stock;

(b) does not provide for payment of the purchase price of the stock on the basis of its value at the time when the obligation to purchase and pay may arise, but permits the New Company to buy the stock at a remote future date, at a price equal to the value that the stock was determined to have had in 1948, plus interest at an inadequate and non-compensatory rate, all payable only if, at the time the obligation to pay may arise, the stock is worth many times the purchase price plus interest;

(c) fixes the purchase price upon a valuation arrived at by speculation and guesswork and upon assumptions having no rational basis in law or fact, and at an amount which is grossly inadequate and confiscatory; and

(2) *procedurally,* because:

(a) The order of the Commissioner approving the Plan of Mutualization is not supported by substantial or competent evidence and was not based upon a fair and open hearing before an impartial tribunal; and

(b) Appellants have not had an opportunity to submit to a judicial tribunal, for determination upon its own independent judgment as to law and fact, their claim that confiscation of their property will result if the Plan becomes effective.

Statement of Facts*

1. *Parties*

The New Company is the successor in rehabilitation of The Pacific Mutual Life Insurance Company of California (the "Old Company"), an appellant on the companion appeal. The appellants on whose behalf this Statement is filed are stockholders of the Old Company, who also are members of a protective committee representing some 60% of its total capital stock. The New Company is the proponent of the Plan of Mutualization. The appellee Commissioner is named both as Insurance Commissioner and in his capacity as Liquidator of the Old Company, in which capacity he owns the capital stock of the New Company as statutory trustee for the creditors and stockholders of the Old Company. Legal title to the stock was transferred to Voting Trustees in 1938, pursuant to a subdivision (e) added to § 1037 of the Insurance Code in 1937. The Commissioner is one of the Voting Trustees.

2. *Seizure of Old Company in 1936; Creation of New Company; 1936 Rehabilitation Agreement*

The Old Company in 1936 was an old-line, highly respected and successful insurance company, which had been organized in 1868, had written life, health and accident

---

*The record on this appeal and the companion appeal is the same, and consists of four folders and certain numbered exhibits. References to "Tr." in this brief refer to Folder One, "Reporter's Transcript of proceedings before the Insurance Commissioner"; "Clk. Tr." to Folder Two, "Reporter's Transcript of proceedings in the Superior Court"; "Op. Br." to Appellants' Opening Brief in the District Court, "Pet. H." to their Petition for Hearing in the Supreme Court, and "Pet. Reh." to their Petition for Rehearing in the Supreme Court—all contained in Folder Three; and "Ex." followed by an arabic numeral to one of the separate numbered exhibits.

policies in California and many other States, and had assets in excess of $200,000,000. In spite of its name, it was a stock company, though it did write some life insurance upon a "participating basis". It had outstanding 508,200 shares of capital stock, distributed among some 3000 stockholders (App., A 21-23; App., D 1-3; Clk. Tr. 2).

The proceedings for rehabilitation of the business of the Old Company commenced in 1936, when the Insurance Commissioner, following a triennial audit of its books, found that its reserves for a particular type of policy—with which it had been having a bad claims experience, especially during the depression years—should be increased by $23,000,000. As such an increase would have made the Old Company technically insolvent under § 986 of the Insurance Code,* the Commissioner took over control of the business as statutory Conservator, put in a new management, organized the New Company as his rehabilitation agency, and turned over the assets and business to the New Company, in exchange for its capital stock and its assumption of all liabilities of the Old Company except those growing out of the type of insurance that had caused the trouble—the non-cancellable accident and health policies ("non-can" policies). Those were assumed upon a scaled-down basis.

The terms on which the New Company took over the assets and business were set forth in a Rehabilitation Agree-

---

*Throughout the litigation resulting from the receivership and rehabilitation proceedings, the courts have been at pains to point out that the Company's difficulties were of a temporary character, not involving true insolvency. *Carpenter* v. *Pacific Mut. L. Ins. Co.*, 10 Cal. 2d 307, 325; *Neblett* v. *Carpenter*, 305 U. S. 297, 299. See also the opinion of the trial court in *Carpenter* v. *Pacific Mut. L. Ins. Co.* (not officially reported), Superior Court, Los Angeles County, December 3, 1936, contained in the Record on Appeal in *Neblett* v. *Carpenter, supra.*

ment (App. F), which the Commissioner, after obtaining approval of the Superior Court, caused the New Company to enter into with himself as Conservator of the Old Company. Certain objecting policyholders took an appeal from the order approving the Rehabilitation Agreement. The Supreme Court of California affirmed the order, *Carpenter* v. *Pacific Mut. L. Ins. Co.*, 10 Cal. 2d 307. This Court granted certiorari and, in *Neblett* v. *Carpenter*, 305 U. S. 297, rejected the contention that the Rehabilitation Agreement deprived the policyholders of their property without due process and impaired the obligation of their contracts, upon the ground that the policyholders were not bound to accept the New Company's policies but were afforded the alternative of recovering from the Old Company for breach of contract.

The Rehabilitation Agreement made provision for restoring gradually to the holders of non-can policies the benefits thereof which the New Company did not assume. The source of funds for such restoration was to be the earnings of the Departments other than the Participating Life Department.* Earnings flowing into the general corporate funds were to be put in a Special Fund for restoration of non-can benefits, in "such amounts as [the]

---

*Under the Rehabilitation Agreement, the Participating Department of the New Company was to be set up as a separate entity, as if it were a separate mutual life insurance company, and its surplus was to be held solely for the benefit of the participating policyholders, except for a rather elaborate provision for an annual contribution by the Participating Life Department toward the payment of non-can liabilities, of 10% of profits derived from participating policies written by the Old Company and reinsured by the New. Inasmuch as the Price Determination Committee later found that the contributions of the Participating Department to the Special Fund for non-can restorations would be so small that they could be disregarded, we omit further reference to those provisions of the Rehabilitation Agreement. (Ex. 28, p. 11)

Board of Directors shall determine to be not reasonably required for the reasonable, proper and profitable conduct of the operations of the New Company as a going concern", subject to the right of the Insurance Commissioner to require transfer of additional amounts to the Special Fund if he thought they were available under the quoted test. (App., F 16).

Neither in the proceedings which culminated in this Court's decision, nor in any of the other litigation involving the Pacific Mutual rehabilitation,* was any issue raised or litigated with respect to the mutualization provisions of the Rehabilitation Plan, next to be discussed.

3. *Mutualization provisions of Rehabilitation Agreement*

The Rehabilitation Agreement, in effect, postponed the operation of the mutualization statutes to the Pacific Mutual situation for ten years, but provided machinery by which mutualization proceedings might be instituted in the future. The machinery might be set in motion at any time from July 1, 1946, to December 31, 1947, by requests from 10% of the holders of *participating* policies that the New Company be mutualized, in which event an Appointing Committee would be constituted and would in turn designate a Price Determination Committee of 3 to 5 persons "skilled in matters of insurance company valuation". The Price Determination Committee (the "PDC") would then (1) determine whether mutualization "can then be practicably accomplished having regard to the interests of all persons interested in the new company," and (2) if, in the opinion of a majority of the PDC, mutualization was "then

---

**Carpenter* v. *Pacific Mut. L. Ins. Co.*, 13 Cal. 2d 306; *Neblett* v. *Pacific Mut. L. Ins. Co.*, 22 Cal. 2d 393; *Caminetti* v. *Pacific Mut. L. Ins. Co.*, 23 Cal. 2d 94; *Caminetti* v. *Pacific Mut. L. Ins. Co.*, 23 Cal. 2d 334; *Sanborn* v. *Pacific Mut. L. Ins. Co.*, 42 Cal. App. 2d 99; and *Garrison* v. *Pacific Mut. L. Ins. Co.*, 83 Cal. App. 2d 1.

practicable", it would go on to "determine the proper price to be paid upon such mutualization and appropriate terms of payment thereof." (App., F 24-26).

By the terms of the Rehabilitation Agreement, the Commissioner restricted his right as Conservator to sell or otherwise dispose of the New Company's stock, except subject to the "option to mutualize", and agreed that, if a plan of mutualization should be proposed in the manner provided for in the Agreement, he and his successors in interest as holders of the New Company's stock would consent to it (App., F 27). However, the Commissioner imposed two conditions on the covenants and consents that he gave in the Rehabilitation Agreement, (a) that if any of the provisions relating to mutualization "should be contrary to law or illegal or void" (App., F 31), that provision would be deemed separable, and its invalidity would not effect the validity of the other provisions; and (b) that his undertakings as Conservator (*e.g.*, his advance consent to a mutualization plan) were made only in his capacity as Conservator or Liquidator, "and to such extent as he had authority to make, and the Conservator makes no warranty of his authority to make the same" (App., F 34).

4. *Mutualization proceedings*

In 1946 the New Company, having obtained the necessary requests from participating policyholders, commenced proceedings for mutualization. A Price Determination Committee (the "PDC") was appointed, and commenced its task early in 1947. It employed a Chief Actuary, Mr. Christman, and a staff, who under instructions of the PDC undertook to make a valuation of the capital stock of the New Company as of December 31, 1948.

The four members of the PDC were distinguished and honorable gentlemen; but it would be hard to maintain on the basis of their connections and ties of interest—and impossible to maintain, we contend, in the face of what they did—that they were impartial, or unsympathetic to the desire of the New Company's management to mutualize, get rid of its stockholding interest and become self-perpetuating. Mr. McAndless, the Chairman, was president of a stock insurance company which enjoyed friendly relations with the New Company and was one of its reinsurers. The two other insurance men on the PDC were executives of large mutual companies; and the fourth member was a partner of a firm that sold securities and numbered the New Company among its important customers (Clk. Tr. 18-19, 66-68).

On November 9, 1949, the actuaries completed their report. They found that the 1948 value of the capital stock of the New Company was $2,614,000 on one assumption as to the future earnings of the Company on its investments (2.9%) and $3,395,000 on a slightly different assumption as to earnings on investments (3.0%). (Ex. 28, p. 2).

On April 4, 1950, the PDC submitted its Report, appending thereto a fully developed Plan of Mutualization. Appendix G hereto contains the PDC report and those portions of the Plan to which we have need to refer.

5. *Finding as to practicability of mutualization*

The PDC in its report made the necessary *jurisdictional* finding that mutualization could *"then* be practicably accomplished"; but it wrote a plan that could not be "practicably accomplished", according to the PDC's own estimates, before 1971—that being the earliest year when restoration of benefits under the non-can policies would

have been completed. The PDC found that the purchase price could not be paid until the non-can benefits had been fully restored, and could not be paid even then unless the Company's financial position was such that, after payment of the purchase price, it would "remain in possession of requisite and satisfactory reserves and in safe and efficient financial condition." (App., G 2).

Visualizing the possibility that non-can restorations might take longer than estimated, or that it might be some years after restoration before the New Company would be in a financial position to buy its stock, the PDC in its report decreed that "the time within which mutualization may be effected [under the Plan] is hereby extended to and including December 31, 1983." (App., G 3).

In short, the PDC made the jurisdictional finding that mutualization could *practicably* be *accomplished* as of December 31, 1948, but extended the time within which mutualization might *actually* be *effected* by 35 years from that date; and it then went on to provide that, if it had not been accomplished by that date, "this Mutualization Plan shall be considered to have failed". (App., G 15).

According to Webster, "Accomplished" means "completed; effected; * * *"

6. *Fixing of the Purchase Price*

Not only did the PDC make a finding, plainly contrary to fact, that mutualization could be practicably accomplished as of December 31, 1948, but it fixed a price that was based upon an imaginary mutualization on that date. The base price to be paid was fixed at $3,000,000, found to be the value of the stock on that date. Interest, at the rate carried by the longest term government bonds (2½% as of 1949) was to be payable on the price from December 31, 1948,

if, as and when the price should ever become payable; and the third element of the price formula was a contingent addition to the price of $250,000 per year (without interest) for each full year (if any) by which non-can benefits shall have been fully restored prior to December 31, 1973. (App., G 5-6).

The arithmetical basis for the findings of value by the actuaries and the PDC is set forth on pp. 9-10 of Exhibit 28, the two sections of which are interleaved between this page and the next page, labeled Chart I and Chart II. The actuaries performed a monumental series of arithmetical calculations, based upon assumptions given them by the PDC—including assumptions with respect to the future operation or influence of each of the 18 variables listed in the margin.*

Using those assumptions, the actuaries computed—for the years 1949 to 2000—what the "pattern" of earnings of the New Company would probably be and how much of them would be available for application to non-can restoration, from the three sources of earnings shown in the heading of the Charts.

---

*Interest rates prevailing from time to time in the money markets; rates at which policyholders would allow their policies to lapse; rates of expenses of the business; probable volume of life insurance written on a non-participating basis; volume of business of the Accident and Health Department; probable rates of disability; rates at which the proceeds of the policies would be left with the Company on option; profits on group insurance; rates on future claims on the non-can policies; persistency of non-can benefits admitted to claim; rates of expenses in administering non-can business; probable or optimum rate of restoration of non-can benefits; average cost of non-can claims once submitted; mortality rates; reserve standards for existing and future life insurance; reserve standards for annuities and disability benefits; amount to be added to surplus to maintain relationship between surplus and volume of business, assets and liabilities; discount rate to be used in estimating value of future earnings on present value basis. (Tr. 249-253, 150-152, 380, 389, and 506.)

CHART I

PACIFIC MUTUAL ESTIMATED FUTURE EARNINGS AVAILABLE TO MEET RESTORATION COST OF $22,000,000

($ M)

Year	Source			Total—Basis A			Total—Basis B	
	Non-participating Life	Cancellable Accident & Health	Earnings on Capital & Surplus 12/31/48	Undiscounted	Discounted @3% to 12/31/48	Provision for .1% per Annum Lower Interest	Undiscounted	Discounted @3% to 12/31/48
1949	138	387	347	872	862	95	777	770
50	—98	401	347	650	626	100	550	531
51	—47	412	347	712	665	106	606	568
52	36	422	347	805	730	111	694	631
1953	40	431	347	818	719	117	701	619
1954	127	438	347	912	779	122	790	677
55	172	445	347	964	799	127	837	696
56	256	452	347	1055	848	133	922	743
57	348	456	347	1151	898	138	1013	792
1958	413	460	347	1220	924	143	1077	817
1959	496	465	347	1308	962	151	1157	853
60	602	468	347	1417	1011	158	1259	900
61	685	471	347	1503	1041	165	1338	929
62	775	474	347	1596	1073	172	1424	959
1963	840	477	347	1664	1086	179	1485	971
1964	917	478	347	1742	1105	184	1558	990
65	1001	480	347	1828	1125	189	1639	1011
66	1064	481	347	1892	1130	194	1698	1016
67	1137	483	347	1967	1141	200	1767	1027
1968	1178	484	347	2009	1131	205	1804	1018
1969	1223	485	347	2055	1123	210	1845	1010
70	1283	486	347	2116	1122	215	1901	1010
71	1340	487	347	2137 37*	1100	220	1954	1008
72	1400	488	347	2235		224	2011	1007
1973	1452	489	347	2288		228	2060 944	1002
1974	1774	509	347	2630		232	1454*	445
Total of Discounted Earnings for Period Needed for Restoration								
Restoration on Basis A; Completed During 1971					22000			
Restoration on Basis B; Completed During 1974								22000

*Earnings during final year of restoration split into two parts. The amount above the line is that required to complete restoration. The amount on the line is available for stockholders.

CHART II

PACIFIC MUTUAL ESTIMATED FUTURE EARNINGS AVAILABLE FOR STOCKHOLDERS FOLLOWING RESTORATION.

($ M)

Year	Source			Total—Basis A			Total—Basis B	
	Non-participating Life	Cancellable Accident & Health	Earnings on Capital & Surplus 12/31/48	Undiscounted	Discounted @ 10% to 12/31/48	Provision for .1% per Annum Lower Interest	Undiscounted	Discounted @ 10% to 12/31/48
				2137				
1971	1340	487	347	37*	4			
72	1400	488	347	2235	240			
1973	1452	489	347	2288	223			
							944	
1974	1774	509	347	2630	232	232	1454*	129
75	1851	510	347	2708	216	236	2472	198
76	1915	510	347	2772	202	239	2533	185
77	1980	510	347	2837	187	242	2595	172
1978	2060	510	347	2917	175	244	2673	161
1979	2111	510	347	2968	162	246	2722	149
80	2166	510	347	3023	150	248	2775	138
81	2208	510	347	3065	138	250	2815	127
82	2247	510	347	3104	127	251	2853	117
1983	2280	510	347	3137	117	252	2885	108
1984	2315	510	347	3172	107	253	2919	99
85	2341	510	347	3198	99	254	2944	91
86	2363	510	347	3220	90	255	2965	83
87	2383	510	347	3240	82	256	2984	76
1988	2401	510	347	3258	76	256	3002	70
1989	2421	510	347	3278	69	257	3021	64
90	2428	510	347	3285	63	257	3028	58
91	2444	510	347	3301	57	258	3043	53
92	2459	510	347	3316	52	258	3058	48
1993	2466	510	347	3323	48	259	3064	44
1994	2470	510	347	3327	43	259	3068	40
95	2478	510	347	3335	40	259	3076	37
96	2483	510	347	3340	36	260	3080	33
97	2484	510	347	3341	32	260	3081	30
1998	2489	510	347	3346	30	260	3086	28
1999	2489	510	347	3346	27	260	3086	25
2000	2494	510	347	3351	271	260	3091	251
To Perpetuity								
Total of Discounted Earnings After Restoration Available for Stockholders					3395			2614

*Earnings during final year of restoration split into two parts. The amount above the line is that required to complete restoration. The amount on the line is available for stockholders.

The actuaries also estimated how much the future non-can claims from year to year would be and, again using assumptions as to future conditions given to them by the Chairman of the PDC, ascertained that the amounts needed for payment of all existing and estimated future non-can claims, discounted to 1948 at a compound interest rate of 3%, came to $22,000,000. They then took their estimates of earnings from 1949 on, and discounted them year by year to 1948 values at the same 3% compound rate, continuing that process until they reached the point where the discounted value of the aggregate earnings reached $22,000,000—the estimated 1948 value of the non-can liabilities. (Ex. 28, p. 8).

That point was reached in 1971 or 1974, depending upon alternative assumptions as to how much return the New Company would earn on its investments—whether 3% or 2.9%. The earnings thus equated with the non-can liabilities were not all the earnings for the years from 1949 to 1971 or 1974, but only those that were "available" for that purpose under a formula which will be described, and which allowed for annual additions to the corporate surplus.

So they said in effect: All the earnings of the Company, otherwise available for dividends to stockholders, will be needed to restore non-can benefits up to 1971 or 1974, and so those earnings will contribute nothing to the value of the stock. Hence they must be left out of account in determining the 1948 value of the stock. That value must be determined by finding out how much the stream of earnings from 1971 or 1974 would be worth to a person purchasing the stock on the fictitious sale date of December 31, 1948.

Accordingly, the actuaries proceeded to find the 1948 value of the estimated stream of earnings from 1971 to 2000 and from 1974 to 2000. They ~~discontinued~~ discounted each year's earnings estimate back to 1948 on a compound interest basis

(but this time at 10%, instead of 3% as for the earlier years). They added approximately $250,000 to the figure for 2000 A. D., to allow for the value of the earnings from the year 2001 to the end of time; and they came out with the two figures given above, which average $3,000,000; and the PDC fixed that figure as the base price.

The actuaries' Report well says of their own estimates:

> "These estimates are, of course, subject to great uncertainty. They are the result of an extensive series of calculations which have been carefully carried out, but which involve assumptions as to happenings in the distant future which may or may not be realized" (Ex. 28, p. 8).

The PDC's computation of the value of the stockholders' equity in terms of the stream of earnings (using the average of its two figures for the years after 1971 or 1974) was in simple terms as follows:

Value of stream of earnings, 1949 to 1971 or 1974, available for non-can restorations	$22,000,000
Value of stream of earnings, 1971 or 1974 to perpetuity, available to stockholders	3,000,000
Total value	$25,000,000
Deduct estimated cost of non-can restorations	22,000,000
Value of stockholders' equity as of December 31, 1948	$ 3,000,000

7. *Provisions for payment of purchase price*

The PDC, having found that the New Company would not be able to pay for its stock until a distant future date, made the payment, at whatever date, subject to three con-

ditions: (a) that non-can benefits had been fully restored, (b) that the New Company's capital and surplus, plus a Special Fund to be created out of profits of the Participating Department, should equal or exceed the purchase price with interest, and (c) that the surplus (after paying for the stock) would still be at least the sum of (i) 4% of the admitted assets of the New Company plus (ii) 25% of premiums collected during the previous year on all group insurance written on a one-year term basis and (iii) 25% of premiums collected during the previous year on all accident and health insurance. (App., G 8).

The drastic character of the third condition may be shown from the New Company's published figures* for 1954:

4% of admitted assets ($493,000,000)	$19,720,000
25% of 1954 group insurance premiums ($5,960,000)	1,490,000
25% of 1954 accident and health premiums ($27,000,000)	6,750,000
Total	$27,960,000

Thus, on the basis of the financial situation of the Company at the end of 1954, it will not come under any obligation to buy its stock pursuant to the Plan of Mutualization unless and until, *after paying the purchase price,* it will have not less than $27,960,000 of surplus left. It will not have to buy its stock for $3,000,000 plus interest, unless and until the book value of the stock is 10 times the price, plus interest.

8. *Proceedings Below*

The mutualization proceedings were had, and the order of the Commissioner was made, under §§ 11525-27 of the

*1955 Best's Life Insurance Reports 970.

California Insurance Code. Section 11525 authorizes a solvent domestic insurer to mutualize and to provide and carry out a plan for that purpose. Section 11526 provides that the plan must be (a) adopted by a majority of the directors, (b) approved by the holders of at least a majority of the outstanding shares, (c) submitted to the Commissioner and approved by him in writing, and (d) approved by a majority of the policyholders for whose benefit the stock is to be acquired. It becomes effective when filed in the office of the Insurance Commissioner after the foregoing requirements have been met. All steps except the last one have been taken. Approval of stockholders was given by the Voting Trustees to whom the Commissioner as Conservator had transferred the stock and by the Conservator himself.* Neither the Old Company nor its stockholders, the beneficial owners of the stock, were given any voice in formulating, or any right to vote on, the Mutualization Plan. Section 11527 provides (App., E 11):

> "The commissioner shall examine the plan submitted to him under the provisions of subdivision (c) of section 11526. He shall not approve such plan unless in his opinion the rights and interests of the insurer, its policyholders and shareholders are protected nor unless he is satisfied that the plan will be fair and equitable in its operation."

The Commissioner held a hearing and heard testimony and argument in support of and in opposition to the Plan from August 1 to 18, 1950, and rendered his decision on September 22, 1950. The New Company and other interested parties, including the appellant stockholders, appeared in the proceeding. Two members of the PDC—the Chair-

*In giving their consent, the Voting Trustees expressly stipulated that they had not considered the merits of the Plan (Ex. 21, p. 4).

man and the banker member—and Mr. Christman, the chief actuary, testified in support of the PDC's finding of value for the New Company's stock, and were cross-examined by appellants' counsel.

The Commissioner in his opinion made reference to three bases of valuation of the New Company's stock which had been mentioned in the testimony—two of which the PDC itself had rejected—and said there was "abundant evidence" to support the PDC's findings; that they had arrived at the $3,000,000 price "in the exercise of their judgment"; and, in effect, that he accepted their judgment (App., D 17-18). The opinion clearly reveals that the Commissioner did not look beyond the PDC's explanation of their valuation of the New Company's stock. He did not avail himself of the facts and figures with which the facilities of his office could have provided him. In essence, he followed the "expert" judgment of the Committee in approving the Plan.

The Commissioner held that the Old Company was foreclosed from objecting to the Plan because it was bound by the 1936 consent given by the Conservator. He did not *say* that the stockholders were similarly foreclosed, but that was the effect of his decision. His conclusory finding was (App., D 24):

> "IT IS HEREBY FOUND AS A FACT that the rights and interests of the New Company, its policyholders, and the holder (sic) of its shares are protected under the terms of the plan hereinabove referred to, and that the plan will be fair and equitable in its operation."

Appellants filed their petition for mandate in the Superior Court, and raised the constitutional questions now before this Court as follows (Clk. Tr. 22):

> "Said order of Insurance Commissioner . . . was and is null and void, and of no effect, and was arbitrary and unreasonable. . . . Said findings of the Insurance Commissioner are . . . contrary to the weight of the evidence, and are not supported by substantial evidence adduced at said hearing, or otherwise. Said Findings and Order of said Commissioner deprive Petitioners . . . of property without due process of law, contrary to . . . the Fourteenth Amendment to the Constitution of the United States. In this respect Petitioners here refer to their Points of Error hereto attached and presented with this petition."

In their Points of Error, appellants objected to the contingent, long-delayed and possibly illusory character of the obligation to buy the stock, the vague, hypothetical and uncertain bases for the PDC's valuation of the stock, and the failure of the Insurance Commissioner to make an independent examination of the fair value of the stock (Clk. Tr. 28, 30, 31, 32, 32-33). The Superior Court overruled appellants' contentions, and said (App., C 33-34):

> "PDC might well have approached the problems presented to it and resolved those problems differently than they did. We may not agree with their approach or with their reasoning, but we cannot say, nor could the Commissioner say, that they acted without reason, and neither the Commissioner nor this Court can substitute his or its reasoning for that of the Committee."

The Superior Court invoked the rule of substantial evidence to support the Commissioner's order, but did not find that the Commissioner himself had considered the evidence and arrived at a conclusion based upon the evidence

before him. What it found was that PDC had reached a conclusion based on substantial evidence *before it.* The Court held that it was not the Commissioner's duty "to look behind the report of the Price Determination Committee and make an independent determination of the value of the stock and the fairness of the price" (App., C 31), that the Commissioner was "bound" to find that the plan was fair to the appellants "unless the evidence disclosed that the Price Determination Committee acted arbitrarily" (App., C 31), and that the Commissioner could not say that the PDC "acted without reason" and could not "substitute his . . . reasoning for that of the committee" (App., C 34).

The Court plainly indicated that, if he had had to decide on the fairness of the Plan upon the evidence before him, he would not have approved it. He said (as quoted in Judge Carter's dissent below, App., A 65; emphasis is Judge Carter's):

> " . . . *I think it must be very evident if I had had this case decided on a new question of fact my decision might have been the opposite.* . . . It was only because I could not convince myself that it was not a rational conclusion that they acted upon that I ever decided the case the way I did. *Because I could not take the facts and arrive at the same conclusion; not by a long shot. But because I did not feel that I could substitute my opinion for the Commissioner's, that is the reason I arrived at the conclusion that I did.*"

In the District Court of Appeal, appellants again raised the constitutional questions. That Court also purported to apply the substantial evidence rule but, like the Superior Court, went on to hold that it was for the PDC to make the determination of value. It said, in response to the contention that the Insurance Commissioner had not made a

determination of value required by his statutory duties (App., B 28):

> "One answer to this is that the power and duty to determine the value and price of the stock was lodged *in the Price Determination Committee and not in the Insurance Commissioner,* by the Rehabilitation and Reinsurance Agreement, and *this committee* was thereby empowered to determine the price to be paid for the stock on any reasonable basis. The determination of value was made by the Committee. . . and we are unable to hold, from the record, that the conclusion *it* arrived at was unreasonable." (Emphasis ours)

Thus the Court wrote out of § 11527 of the Insurance Code what on its face appears to be a requirement that the Commissioner must make an independent determination of the fairness of any voluntary mutualization plan; and by doing so, we contend, the Court rendered the statute unconstitutional. The District Court of Appeal also passed specifically on appellants' claim with respect to substantive due process (App., B 34). It noted:

> "Another point raised by the appellants is that they have been deprived of substantive due process because the stock of the New Company was valued as of the present, that the time of payment was fixed long in the future, payment was conditional, there was no provision for reasonable interest, and the price paid was grossly inadequate."

Those contentions were disposed of by a holding that "the commissioner's approval of the plan of mutualization did not have the effect of taking appellants' property, since it was nothing more or less than a permit. . . ." (App., B 34).

Appellants raised the questions here presented in the California Supreme Court (Pet. H. 71-84). Their conten-

tions as to substantive and procedural due process were rejected. The Court said (App., A 14):

> "The approval of the mutualization plan by the Commissioner did not involve any deprivation of property rights or vested rights . . . the function of the superior court was to determine whether the action taken by the commissioner was arbitrary or constituted an abuse of discretion, and in upholding the action of the commissioner, it properly refused to conduct a trial de novo."

Justice Carter's dissenting opinion sets out at length the reason for his conclusion that, under the decisions of this Court, appellants were denied due process of law under Amendment XIV. (App., A 61-66).

Appellants' Petition for Rehearing in the California Supreme Court was based upon the Federal constitutional questions above specified. (Pet. Reh. 27-42).

9. *Res Judicata*

The courts below held, in substance, that the Rehabilitation Agreement was binding upon the Old Company and that the procedure for bringing about mutualization was a matter of *res judicata*. The issue of *res judicata* is discussed at length in the opinions of the majority and dissenting judges in the California Supreme Court (App., A 8-12, 13, 19-21, 47-56). By invoking *res judicata*, the courts below were able to avoid a number of troublesome issues; but they did not, we submit, avoid the issue of confiscation, or the issue of a fair hearing and adequate judicial review, which are presented in the argument to follow. If the requirements laid down by this Court in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, have a constitu-

tional basis, then the application of *res judicata* by the courts below resulted in, or contributed to, a denial of due process of law.

Substantial constitutional questions are raised on this appeal

Substantive due process

The order of the Commissioner—which was an exercise of delegated legislative power,* and therefore a statute within the meaning of § 1257(2) of the Judicial Code—is unconstitutional because it provides for the taking of appellants' property at a price that is plainly confiscatory. The Plan of Mutualization derived its compulsory character from the Commissioner's order; hence the property of appellants has been taken by the State itself. *Doty* v. *Love*, 295 U. S. 64; *Union Dry Goods Co.* v. *Georgia P. S. Corp.*, 248 U. S. 372; *Eubank* v. *Richmond*, 226 U. S. 137.

1. It was plainly a violation of due process to provide for the taking of appellants' property at a remote future date upon payment of a price equal to a value determined as of a date many years before. See *Olson* v. *United States*, 292 U. S. 246, 254-55.

---

*Mutualization of an insurance company is a legislative function, an exercise of the reserved power of the legislature to alter, amend and repeal corporate charters; and the order of the Insurance Commissioner approving the particular plan of mutualization was legislative in character. *Lord* v. *Equitable Life Assurance Society*, 194 N. Y. 212. While, to perform his delegated function to pass on the fairness of the Plan, the Commissioner had to act quasi-judicially, his order had a legislative effect and was a legislative act. *Belden* v. *Union Central Life Insurance Co.*, 143 Ohio St. 329; *In re Prudential Insurance Company*, 82 N. J. Eq. 335; *Rippel* v. *Prudential Insurance Company*, 85 N. J. L. 395; *Application of Prudential Insurance Company*, 132 N. J. Eq. 170.

Mutualization is a form of corporate reorganization; and the courts in reorganization proceedings must determine values as of the time when interests are taken or adjusted. This Court has said: "Valuation on the basis of a going concern necessarily has primary relationship to value as of the time the shareholders' surrender becomes effective, not as of some earlier, remote period or one long afterward." *SEC* v. *Central-Illinois Corp.*, 338 U. S. 96, 138, 139. *Cf. St. Joe Paper Co.* v. *Atl. Coast Line R. R.*, 347 U. S. 298, 300; *In re Equitable Office Bldg. Corp.*, 96 L. Ed. 1386, not officially reported; *Ecker* v. *Western Pacific R. R.*, 318 U. S. 448, 462; *Matter of Globe & Rutgers Ins. Co.*, 148 Misc. 497, 501.

The utterly confiscatory character of the PDC's device of fixing values as of 1948, when payment is not to be made until some remote future date, may be seen from its own figures. The PDC valued future earnings available to stockholders (after 1971 or 1974) on a 10% compound discount basis. If we follow that method, and discount the estimated earnings up to the year 2000, but to their "present value" as of 1974 instead of 1948, we get a 1974 valuation of those earnings of approximately $27,700,000. Thus if the stock is bought and the price paid in 1974, the situation will be as follows:

Value of stockholders' equity in 1974, based on PDC's estimates of earnings from 1974 to perpetuity		$27,700,000
Purchase price:		
1948 value	$3,000,000	
Interest at 2½%, 1949 to 1974	1,875,000	
Total price		4,875,000
Excess of estimated value of stockholders' equity over price to be paid for it at the time of purchase		$22,825,000

Thus the owners of the equity will be paid a little over 20% of the value of their property at the time it is taken —not the value asserted by us, but the value based on the PDC's own figures. Under all the authorities, they are entitled to the value at the time of purchase.

The New Company will not become obligated to purchase and pay for its stock until a number of conditions have been fulfilled, one of which is that the non-can restorations—estimated to require a capital fund of $22,000,000, as of 1948—shall have been paid off. Those liabilities will be restored out of earnings available for the purpose over the years; and meanwhile, according to the PDC's estimates, the business, the assets and the surplus of the New Company will gradually increase, so that the value of the equity—before non-can deductions—will never be less than $25,000,000. But when the non-cans are paid off, the $22,000,000 deducted from the 1948 equity value will have dis-

appeared; and the net value of the stockholders equity will be at least $25,000,000.

So the proposal that the New Company has made to the Old Company and its stockholders amounts to this: Your property was worth $3,000,000 on December 31, 1948. When it has increased in value to not less than $25,000,000 (and provided other conditions are satisfied), we will buy it for $3,000,000 plus interest.

In *Matter of New York Title & Mortgage Co.*, 171 Misc. 489, the New York courts, on objection of stockholders, disapproved a similar but infinitely less drastic proposal of the Superintendent of Insurance to fix the price for sale of the company's assets, where payment would be delayed pending fulfillment of certain conditions. The Court held that the price would have to be approved at the time when the sale was actually made, pointing out that there might be an increase in the value of the assets before that time, and that the stockholders were entitled to the benefit of such an increase if it occurred. That decision is only an application of the generally accepted principle that when property is taken it must be paid for at the value at the time of the taking. *Monongahela Navigation Co.* v. *United States*, 148 U. S. 312; *Olson* v. *United States*, *supra*.

2. When a public authority takes property, due process requires that it make adequate provision for *certain* and *not unreasonably delayed* payment of just compensation to the owner. *Cherokee Nation* v. *Kansas R. R.*, 135 U. S. 641; *Sweet* v. *Rechel*, 159 U. S. 380; *Backus* v. *Fort Street Union Depot Co.*, 169 U. S. 568. Where, as in our case, the State is taking property from one private group and giving it to another, the application of that standard seems

more compelling than in the case of condemnation, where public purposes are being served. See *Thompson* v. *Consolidated Gas Co.*, 300 U. S. 55, 79-80.

In this case, the equitable ownership of the stock of the New Company has been subjected to a 35-year option; and for that option *no compensation whatsoever* has been paid. The Old Company and its stockholders have been deprived of the ordinary right of a property owner to determine when he will sell and for how much—a right that is "property" within the protection of Amendment XIV. See *Old Dearborn Co.* v. *Seagram Corp.*, 299 U. S. 183, 192; *Buchanan* v. *Warley*, 245 U. S. 60, 73.

The stockholders of the Old Company have been deprived of the right to raise money to pay off the non-cans and redeem their equity, or to get back their property when the non-cans shall have been paid off (App., F 29-30). Control of the stock of the New Company will be turned over to Voting Trustees, whose status and duties have been meticulously phrased to exclude any possible fiduciary obligation or relation to the Old Company or its stockholders (App., G 16); and thus appellants will be deprived of the benefits of the trust (with the Conservator as trustee) which the statute created for the protection of all interests, including theirs.* (App., C 22-23, 25).

---

*The stockholders have also been deprived of one of the most important safeguards provided for them in the Rehabilitation Agreement—that the New Company must follow a policy of writing at least 50% of its life insurance as non-participating insurance. The stockholders derive no benefit from the participating insurance, since the Rehabilitation Agreement set up the Participating Department as if it were a separate mutual company. Therefore the New Company could completely defeat the interests of stockholders, postpone the date of purchase of the stock and keep the purchase price down by writing more participating and less non-participating insurance. The provisions of the Plan of Mutualization affecting this point are so outrageously watered down that the stockholders are without practically any protection against such a course by the New Company (App., G 12-13).

Preserving the fiction that mutualization was being accomplished as of December 31, 1948, the PDC even deprived the stockholders of the value of their interest in those earnings prior to 1974 which will be added to surplus from year to year. While not the most significant in terms of value, this was perhaps the PDC's most extraordinary departure from accepted principles governing the valuation of the stockholders' equity in a corporation.

In arriving at its earnings figures for the years 1949 to 1974, the PDC *deducted* $190,000 per year to be added to surplus, on the theory that, as the business grew, the surplus should be allowed to grow in proportion (Ex. 28, p. 12; Tr. 545-47). It also *excluded* from earnings all money that might be earned on those additions to surplus. The balance of annual earnings was what it found to be available for non-can restorations.

It then valued at zero the stockholders' equity in the "stream of earnings" to 1971 or 1974, available to restore non-cans, ignoring the stockholders' interest in the gradually increasing surplus. The PDC seems to have labored under the curious misconception that, if earnings are retained and ploughed back into the business, they do not add anything to the value of the stockholders' interest. What the Committee did, in excluding the accumulating surplus as an element of value, is as absurd as it would be to appraise the stockholders' equity in U. S. Steel without taking account of the billion dollar surplus which that corporation has built up.

On the PDC's figures, the increase in the corporate surplus to 1974 was to be $7,260,000 (Tr. 693-94). If the PDC had taken that factor into account, and discounted it back to 1948 as it did the other figures for the 1949-1974 period, it would have found the stock of the New Company to have a value, as of December 31, 1948, of about

$3,500,000 more than it actually found. Its computation of price, as shown above (p. 14) would have to be revised as follows:

Value of stream of earnings, 1949 to 1971 or 1974, available for non-can restorations	$22,000,000
Value of stream of earnings thereafter, to perpetuity, available to stockholders (average figure)	3,000,000
Value of stream of earnings, 1949 to 1974, not available for non-can restorations but added to corporate surplus and stockholders' equity	3,500,000
Total	$28,500,000
Deduct cost of non-can restorations	22,000,000
Value of stockholders' equity as of December 31, 1948	$ 6,500,000

When compared with the other outrageous departures from proper and constitutional methods of valuation which the PDC made, this is a minor one. Yet it alone produced an undervaluation of $3,500,000—on the PDC's own figures, and even conceding that it will be proper to buy the stock in 1974 at its 1948 value.

In considering the rights and property interests of which the stockholders have been deprived, pending either the consummation of the Plan or the return of their stock if the Plan fails, it must be noted that, because of the third condition imposed upon the obligation to pay—that relating to the amount of surplus that the New Company must have before it will be obligated to pay*— there may be a long interval between the restoration of non-can benefits and

*Supra, p. 15.

payment of the price. This point is particularly significant in relation to the $250,000 price adjustment provision, and it is discussed in more detail under that heading, but it also deserves mention here.

It could happen that the non-can restorations would be completed as early as 1963; and yet it might be 1983 before the New Company would have the large surplus which it must have before it is obligated to buy—an interval of 20 years. During that time, according to the estimates of the PDC, aggregate earnings will approximate $50,000,000; and they would be available for dividends on the stock, the non-cans having been paid off. Yet the Plan makes no provision for payment of any dividends on the stock; it does not contain a single reference to any rights of the Old Company or its stockholders. As it would clearly be contrary to the interests of the management of the New Company to pay dividends during the 20-year interval assumed, and as they would have no obligation to do so, the stockholders in the case supposed would be deprived of a return on their investment for 20 years, though the earnings would be (on the PDC figures) ample to give them a handsome return.

4. The provisions of the Plan of Mutualization for interest on the purchase price are inadequate and confiscatory in three respects, (a) the rate fixed, (b) the time of payment and (c) its contingent character.

The purpose of interest, where property is taken and payment delayed, is to give the owner "such addition as will produce the full equivalent of that value paid contemporaneously with the taking." See *Seaboard Air Line R. R.* v. *United States*, 261 U. S. 299, 306; *Jacobs* v. *United States*, 290 U. S. 13; *Phelps* v. *United States*, 274 U. S. 341. That means interest at compensatory rates.

Simple interest at 2½%, even if payable currently, would have been inadequate. See *Louisville Bank* v. *Radford*, 295 U. S. 555, 591, 592. Payable at the end of 25 years or longer, 2½% interest is equivalent to not more than 1.99% payable annually—obviously a confiscatory rate.

The PDC defended the interest provisions on the ground that they called for as much interest as the New Company could afford to pay (Tr. 157). There is no better example of the bias of the PDC. If the New Company was not able to pay a fair and compensatory rate of interest on the postponed payment of any price that might be fixed, then clearly, and apart from all other factors, mutualization was not *then practicable*. But, the PDC, having found mutualization practicable, resolved the problem by fixing an interest rate far below the compensatory level.

5. The provision of the Mutualization Plan for upward adjustments of price was also grossly confiscatory. The Chairman of the PDC explained that provision as follows:

> "We reasoned that if profits were higher or restoration costs were lower than anticipated, restoration would be completed that much sooner, and the profits for stockholders interest would then accrue not from 1973 but from some earlier date. We found by calculation that if we drew the line one year earlier, two years earlier, etc., discounting the residual earnings in the same way as before, we would increase the price by something approaching $250,000 for each yearly step. Our Report provides for such an addition to the price, that is, $250,000 for each full year by which the completion of restoration antedates the end of 1973, with interest from the date of restoration." (Tr. 155)

Thus, by taking its estimates of pre-1974 earnings (which exceeded two million dollars for every year from 1968 on) and discounting those earnings back to 1948 at 10% compounded, the PDC got a rough figure of $250,000 per year for the years that it thought might be involved in a price adjustment. This time, however, for some unfathomable reason, interest was not to be paid on the additional element of price from December 31, 1948, but only from the date when non-can benefits had been restored. If the $250,000 per year price adjustment were otherwise fair and reasonable, it would be confiscatory because of the interest provision alone. But it is wholly unjustifiable apart from the disallowance of interest, and is calculated to produce a windfall for the future mutualized company. It gives the owners of the equity $250,000 for each annual sum of over $2,000,000 which they contribute to the New Company, over and above what the PDC estimated they would contribute.

Let us suppose that the restoration of non-cans is greatly accelerated, and is completed in 1963. There will then be 10 years for which a price adjustment has to be made, and the price of the New Company's stock will be increased by $2,500,000. The earnings for those 10 years, upon the lower of the PDC's two estimates, will aggregate $18,237,000. The Plan of Mutualization proposes, therefore, that, for $18,237,000 of increased assets that the equity owners contribute to the New Company, they will be paid $2,500,000, and the balance of $15,737,000 will be retained as a windfall for the future mutualized company.*

*These figures could be made more startling by taking into account the accumulated surplus which is *counted out* in valuing the stockholders' equity.

The $250,000 price adjustment provision is particularly shocking when it is recalled that restoration of non-can benefits may occur many years before the New Company becomes obligated to buy the stock and pay the purchase price. In our supposed case, where restoration of non-can benefits is completed in 1963, the Company might not be in a position to pay the price until 1983. In each of the intervening years, on the Committee's own figures, the New Company would be appropriating to itself, and adding to its surplus, annual earnings ranging—as estimated by the Committee—from roughly $1,700,000 to $3,137,000, or total earnings of about $50,000,000. In return for that aggregate addition to surplus—plus 20 years of earnings on that surplus—the New Company under the Plan would pay an additional price of $2,500,000, with interest of $1,250,000.

If we assume that non-can restorations are only slightly accelerated, and that only the years 1971 and 1972 will be involved, the figures on a comparative basis are just as shocking. The New Company will get the benefit of estimated additions to surplus of $4,170,000, for which it will pay $500,000 plus $25,000 of interest. Then, if payment is delayed until 1983, it will have built up in the intervening years an additional surplus of over $31,000,000, according to the PDC estimates—surplus represented by securities and hard cash—for which it will pay nothing except $962,000 in the form of interest.*

---

*The Plan seems to have been written to make delays in payment to the equity owners as profitable as possible for the New Company. If there is a 20 year delay, or 10 year delay, after restoration of non-cans, the Company will have to pay 2½% simple interest on the price, but it will enjoy the earnings on the equivalent amount of money at either 2.9% or 3% *compounded*, according to the PDC's estimate.

The incredible confiscation of property values which the $250,000 price adjustment provision permits is accomplished by the constitutionally unthinkable device of fixing a price to be paid in 1971 or 1983, or whatever it may be, in terms of values on December 31, 1948. Clearly the members of the PDC—however distinguished they may have been as actuaries and a banker—had not the dimmest appreciation of the rights of stockholders in a corporate reorganization.

Can there be any doubt that Judge Carter, dissenting in the court below, was justified in his statement (App., A 64), that

> "It surely must be crystal clear to everyone who can think that such an outrageous confiscation of property without due process of law has never before taken place in this state."

6. The Plan of Mutualization is confiscatory because it establishes a price for the stock which is based on speculation and guesswork, and upon assumptions having no rational basis in law or fact.

No one, however skilled in actuarial methods, can make an estimate of how much a business corporation is going to earn, in a period from 25 to 50 years in the future, which is more than a wild guess. How could anyone in 1949 make even an *educated* guess as to what interest rates would prevail, what investments insurance companies would be allowed to make, how much they might yield, at what rate policies would lapse, or what the expenses of doing business would be, in the years 1974 to 2000—to mention only a few of the variables?

Almost every assumption made by the PDC is at least debatable. For example, it assumed that mortality rates in the last quarter of the 20th Century would conform to the

past experience of Pacific Mutual—in the face of the progressive and continuing decline in mortality rates that has been going on since the beginning of the century (Tr. 150, 389).

Valuations based on estimates of factors so far in the future are almost certain to be undervaluations, when made by men with conservative habits of mind, like actuaries. With so many factors to evaluate, the effect of conservative estimation increases in geometric fashion. That the PDC was ultra-conservative in its estimates of earnings is readily demonstrable. For example, the PDC estimated that the annual amount available for non-can restorations would not reach $1,900,000 until 1967, upon the more favorable of its two assumptions. Actually, in the very first four years of the PDC's estimates—1949 to 1952—the average annual amount *applied* to non-can restorations *exceeded* $1,900,000 per year. The following compares the Committee's estimates with the actual figures (Op. Br. 127).

	Estimated	Actual
Amounts available for non-can restorations:		
From non-participating life policies	$ 29,000	$3,008,000
From accident and health policies	1,622,000	4,606,000
	$1,651,000	$7,614,000

Thus the Committee underestimated the available earnings from the sources mentioned, for 1949 to 1952 alone, by almost $6,000,000—a margin of error of some 361%.

Some of the major factors bearing on the Company's prospects, which the PDC ignored, are noted in the margin.*

Procedural due process

The order of the Commissioner approving the Plan of Mutualization is unconstitutional because, contrary to the requirements of due process, it is not supported by substantial or competent evidence, and was not based upon a fair and open hearing before an impartial tribunal; and §§ 11525-27 of the California Insurance Code are unconstitutional because, as construed and applied by the courts below, they have deprived appellants of a judicial determination of their rights and of a judicial review of an order which, they claim, confiscates their property.

1. For reasons already stated, we submit that the evidence upon which the PDC acted, and which the Commissioner accepted, was neither substantial nor reliable. "Plausible anticipations" and "flights into the realm of pure speculation" cannot be treated as evidence of value. See *Connecticut Co.* v. *Palmer,* 305 U. S. 493, 505; *Morgan* v. *United States,* 298 U. S. 468, 479-80; *West Ohio Gas Co.* v. *Comm.,* 294 U. S. 79, 82. The factors on which the PDC based its estimation of future earnings were "too contingent, too unique for guidance by experience, to permit rational

---

*Among the factors that the PDC did not consider were the rapid growth of the population of the country and the expansion of industry, with a continuous increase in the number of those gainfully employed; the progressive increases in real wages and in the standard of living of low-income groups; and the phenomenal growth, both in population and industry, of the States of California and Texas, where a major part of the Company's business is done.

assessment". *United States* v. *Westinghouse,* 339 U. S. 261, 267.

2. The California Insurance Code provides two procedures for the mutualization of insurance companies. One relates to the *involuntary* mutualization of *the business of* an insolvent insurer (App., E 1). It calls for the commissioner to propose the mutualization plan, the Superior Court to pass upon it after hearing all parties and appointing appraisers to value the capital stock, and the court to make a finding of the "reasonable value of the shares, including the goodwill, if any". (App., E 7).

The *voluntary* mutualization statute (§§ 11525-27) provides for a method of mutualization exerting no compulsion on stockholders. They may vote on the plan. If it is approved by the Commissioner as fair and equitable to all concerned, the Company is authorized to buy its stock, at the price fixed by the plan, and must buy it from stockholders who are willing to sell at that price; but there is no compulsion upon any stockholders to sell his stock unless and until he wants to do so, or at any price except his own.

The voluntary mutualization statute, on its face, seems to meet all requirements of due process. It appears to encompass those instances where a stock company, in the exercise of a free choice, seeks to change to a mutual company. The court below, having found the voluntary mutualization statute to be applicable, held that the Commissioner's order was nothing more than a permit to the New Company to purchase its stock. That would have been true in the ordinary voluntary mutualization, where the stockholders have the right to disapprove any plan proposed, and to keep their stock if they wish to do so. But in this case, by treating the Commissioner as the owner of the stock, with

the right to consent to a plan of mutualization—and without reference to the wishes of stockholders of the Old Company for whom he is trustee—the California courts have permitted an *involuntary* mutualization to be carried out under the *voluntary* mutualization statute.*

By construing the order of the Commissioner as involving no more than the granting of a permit or a license, the courts below brought into play the judicial review provision of the California Code of Civil Procedure, § 1094.5(c), which imposes a test of "substantial evidence in the light of the whole record", rather than the test of the "independent judgment [of the court] on the evidence", which is applicable in cases where property is taken or vested rights affected (App., A 14-15, 57-62).

By their construction of the voluntary mutualization statutes, the California courts have deprived appellants of the independent judicial review that is required by Amendment XIV where an order of a State agency has been attacked as confiscatory. In such cases, this Court has held—even where the "taking" is for public purposes rather than for the benefit, as here, of private persons—that the State courts must review administrative action by examining and weighing the evidence, and must determine whether or not the consideration provided is below the level of just compensation. *Ohio Valley Co.* v. *Ben Avon*

---

*Either the consent of the stockholders whose property is to be taken, or a judicial determination of the value of their interests, is required by every one of the 18 mutualization statutes in the United States. The statutes are collected in Parish, *The Mutualization of a Legal Reserve Stock Life Insurance Company*, 11 Proc. of Assn. of Life Insurance Counsel 475, 479-483 (1952-1953). Some of the statutes, *e.g.*, Page's Ohio Code, c. 3913, provide for the taking of stock of dissenting stockholders if a majority has approved mutualization, but provide for a judicial appraisal of value.

Borough, 253 U. S. 287, 289; *United Railways* v. *West*, 280 U. S. 234, 251. *Cf. St. Joseph Stockyards Co.* v. *United States*, 298 U. S. 38, 49-52; and see Frankfurter, J., concurring in *Alabama Comm.* v. *Southern R. R.*, 341 U. S. 341, 362.

With two exceptions, anything less than full and independent judicial determination or review of valuation is unknown in reorganization proceedings in this country. See *Kelley* v. *Everglades District*, 319 U. S. 415, 418, 419-426; *Case* v. *Los Angeles Lumber Co.*, *supra*; and *cf.*, *Penn Co.* v. *Pennsylvania*, 294 U. S. 189, 197, and *Pennsylvania* v. *Williams*, 294 U. S. 176, 182-186, where this Court scrutinized the adequacy of State statutory provisions with respect to liquidation procedures for insolvent insurance companies and building and loan associations.

This Court has sanctioned the substantial evidence form of judicial review, in reorganization proceedings involving property valuations, in only two situations so far as we are aware—the ICC railroad reorganization cases and the SEC public utility holding company simplifications. *Ecker* v. *Western Pacific R. R.*, *supra*; *RFC* v. *Denver R. R.*, 328 U. S. 463; *SEC* v. *Central-Illinois Corp.*, *supra*; *Niagara Hudson Corp.* v. *Leventritt*, 340 U. S. 336. In the *Ecker* case the Court explained its adoption of the substantial evidence rule as resting upon exceptional and compelling circumstances of public policy (318 U. S. at 468). The present case involves no comparable circumstances. The Insurance Commissioner was not dealing with a matter in the field of public regulation, and he was not concerned with striking a balance between public and private interests. What he had before him was a corporate reorganization in which there was a problem

of the just apportionment of corporate assets among private parties—stockholders, non-can policyholders and the New Company itself.

3. The hearing before the Commissioner could not be a fair and open hearing before an impartial tribunal, because the Commissioner was involved in a hopeless conflict of interests. His predecessor in office was the proponent of the Rehabilitation Agreement. As Conservator he was a statutory trustee for the Old Company and its stockholders; his advance consent, we submit, might limit but could not destroy his fiduciary obligations. He was a Voting Trustee of, and the controlling person in, the New Company (App., A 33-34; G 9-10); and he was called upon to judge the plan which the New Company had proposed, and the directors and voting trustees of the New Company had accepted, by which those conflicting interests were to be resolved. The decision below—that he could so act without judicial review, if he did not act arbitrarily or without evidence—is, we believe, without precedent.*

The California statutory provisions involved in this case were "copied, substantially from similar provisions in the New York Insurance Law". See *Carpenter* v. *Pacific Mut. L. Ins. Co., supra*, 10 Cal. 2d at 328. The limited judicial review afforded below on the issue of valuation departs from the practice observed under both the New York prototype statute and other State mutualization statutes (see footnote, p. 37), and from the standards of judicial review observed in valuation matters in corporate reorganization proceedings generally. The New York courts

---

*See Davis, Administrative Law (1951) ch. 19, "Nonreviewable Action".

have exercised a close supervision over all phases of insurance company rehabilitation proceedings* for the reason, among others, that in New York, as in California, the Commissioner (Superintendent) "has been forced by the statutes defining his duties to accept the position of acting for conflicting and antagonistic interests." See *Matter of Nemerov*, 149 Misc. 797, 805-06.

Conclusion

The California courts failed to accord to appellants the judicial review that is appropriate to cases where property is taken and confiscation claimed. Had they done so, the Mutualization Plan almost certainly would have been disapproved, because the court of first instance plainly said that he would not have approved it on the evidence before him (App., A 65).

But whatever the proper scope of judicial review, the Mutualization Plan is utterly confiscatory, and should have been found to be so even on the most limited type of review.

From the figures given above, it must be clear that the New Company's stock is worth many times the price fixed for it; and our figures, except in two instances, have been the PDC's own estimates, made in 1949. Were we to take the New Company's published figures—showing earnings, additions to surplus and general business progress far beyond what the PDC estimated—it would be clear that

---

*The New York State Superintendent of Insurance functions, in such proceedings, virtually as a receiver. The New York courts exercise this form of close judicial control because they consider that their function as courts of equity is brought into play. *Matter of Casualty Co. (Rubin Claim)*, 244 N. Y. 443; *Matter of New York Title & Mortgage Co.*, 168 Misc., 60; *Matter of New York Title & Mortgage Co.*, 171 Misc. 489; *Matter of Lawyers Mortgage Co.*, 169 Misc. 802, *aff'd*, 256 App. Div. 974.

the New Company's stock is worth much more than the PDC's estimates would indicate.

While the case was before the District Court of Appeal, one of the country's leading financiers, Mr. Clint W. Murchison of Dallas, Texas, offered to pay $17,000,000 to the Old Company in exchange for preferred stock and approximately one-half the equity stock *of the Old Company*. That amount would have been sufficient for non-can restorations to be completed, all other liabilities of the Old Company to be paid off, the receivership to be lifted and the New Company's stock turned back to its owner, the Old Company. The matter was brought before the District Court of Appeal; but the Court held that it could not consider the offer, and that if it could, the offer would be only "cumulative" evidence of value. (App., B 35-36).

Under color of law, with the acquiescence of State officials and the California courts, and with the participation and assistance of a group of experts of the utmost respectability, the Management of the New Company has carried out one of the most astute and best planned raids on the interests of stockholders that has ever been perpetrated in American financial history. Its dimensions stagger the imagination, and produce the natural reaction that it just cannot be so. But it is so. The Management has put itself in the position where it can continue to enjoy possession of appellants' property, and the fruits thereof, for 28 years, without paying a nickel's worth of compensation, and then, at its own convenience, can buy them out for a fraction of what their property is worth.

It is submitted that the courts below decided erroneously constitutional questions of general importance, which this Court should hear and determine on appeal.

Respectfully submitted,

ALFRED MCCORMACK,
JOHN LOGAN O'DONNELL,
Attorneys for Appellants.

PEYTON FORD,
ALAN Y. COLE,
Of Counsel.

December 21, 1955.

FILED
DEC 21 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 584

FRANK GENTLES, DON F. GATES, RANDOLPH CALDWELL and FRANCIS V. NIXON,

Appellants,

vs.

F. BRITTON McCONNELL, as Insurance Commissioner of the State of California, F. BRITTON McCONNELL, Insurance Commissioner of the State of California, as Liquidator of The Pacific Mutual Life Insurance Company of California, and PACIFIC MUTUAL LIFE INSURANCE COMPANY, a California corporation,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

APPENDICES TO JURISDICTIONAL STATEMENT

ALFRED McCORMACK,
JOHN LOGAN O'DONNELL,
Attorneys for Appellants

PEYTON FORD,
ALAN Y. COLE,
Of Counsel

INDEX

PAGE

Appendix A—Opinion of the Supreme Court of California A-1

Dissenting Opinion of Justice Traynor A-16

Dissenting Opinion of Justice Carter A-21

Appendix B—Opinion of the District Court of Appeal, First District, Division Two B-1

Appendix C—Opinion of the Superior Court for Los Angeles County C-1

Appendix D—Opinion and Decision of the California Insurance Commissioner D-1

Appendix E—Pertinent Provisions of the California Insurance Code and Code of Civil Procedure E-1

Appendix F—Rehabilitation and Reinsurance Agreement F-1

Appendix G—Report of Price Determination Committee and pertinent portions of Plan of Mutualization G-1

Appendix H—Judgment appealed from H-1

APPENDIX A

Opinion of the Supreme Court of California and dissenting opinions of Justices Traynor and Carter